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**SAY IT AIN'T SO!:
HOW THE SEVENTH CIRCUIT'S HOLDING IN
EDELSON V. CH'IEN UNNECESSARILY NARROWS
THE SCOPE OF SECTION 13(D)'S IMPLIED
PRIVATE RIGHT OF ACTION**

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Cite as: Mark A. Diomede, *Say It Ain't So!: How the Seventh Circuit's Holding in Edelson v. Ch'ien Unnecessarily Narrows the Scope of Section 13(d)'s Implied Private Right of Action*, 2 SEVENTH CIRCUIT REV. 409 (2006), at <http://www.kentlaw.edu/7cr/v2-1/diomede.pdf>.

INTRODUCTION

In 1968, Congress passed the Williams Act as a response to the increased use of cash tender offers as a means for achieving corporate takeovers.¹ The purpose of the Williams Act was to ensure that public shareholders were provided adequate information about the qualifications and intentions of third parties making cash tender offers or acquiring large blocks of shares in publicly held companies as a

* J.D. candidate, May 2007, LL.M. in Financial Services Expected 2008, Chicago-Kent College of Law, Illinois Institute of Technology; DePaul University, B.A. *with highest honors*, May 2003. Mark A. Diomede would like to thank his family, namely his wife Elizabeth and son Sam, for their unconditional love and support. He would also like to thank Professor Felice Batlan for her confidence, guidance, and support in his legal writing and in his professional development. He dedicates this article to them, as well as in loving memory of Marisa Diomede and Saverio Diomede.

¹ *Piper v. Chris-Craft Ind. Inc.*, 430 U.S. 1, 22 (1977); The Williams Act amended the Securities Exchange Act of 1934, 15 U.S.C. 78m.

means to possibly contest company control.² Prior to enactment of the Williams Act, there was a “gap” in federal regulation in that tender offers and acquisitions of substantial amounts of stock having a potential for control were not subject to registration and disclosure requirements as were corporate acquisitions by proxy solicitations or by exchange offers of securities.³ In particular, Section 13(d) of the Williams Act was largely intended to alert shareholders of a large accumulation of stock by a party that may potentially affect control.⁴ Accordingly, any person who acquires more than 5% of a class of registered equity security must send to the issuer and the exchanges on which the security is traded, and file with the Securities and Exchange Commission (“SEC”), a Schedule 13D indicating their intent with regards to such acquisition.⁵ Specifically, Section 13(d)(1) requires the disclosure of: (A) the background and identity of the persons filing, (B) the source and amount of funds for any purchases, (C) any potential plans to assert control over the issuer, (D) the number of shares owned and (E) information concerning any arrangements or understandings with any person with respect to any securities of the issuer.⁶

While the Williams Act did not contain an explicit private right of action, courts soon held that such an implied right existed.⁷ The existence of an implied right of action under Section 13(d) has not

² *Ind. Nat’l Corp. v. Rich*, 712 F.2d 1180, 1183 (7th Cir. 1983); S. Rep. No. 550, 90th Cong., 1st Sess. 2 (1967).

³ *Ind. Nat’l Corp.*, 712 F.2d at 1183 (“Whereas corporate acquisitions by proxy solicitations or by exchange offers of securities were subject to registration and disclosure requirements, *see* 15 U.S.C. §§ 78n, 77e, tender offers or acquisitions of substantial amounts of stock having a potential for control were not subject to similar requirements”).

⁴ *Id.*; 113 Cong. Rec. 854 (1967); *see also* H.R. Rep. No. 1711, 90th Cong., 2d Sess. 4 (1967).

⁵ Securities Exchange Act § 13(d)(1); Rule 13d-1; 17 C.F.R. § 440.13d-101.

⁶ *See* Securities Exchange Act § 13(d)(1).

⁷ *Ind. Nat’l Corp.*, 712 F.2d at 1183 (Additionally, the Williams Act was modeled after Section 14(a) which contained also contained a private right of action); *see* *Gen. Time Corp. v. Talley Ind., Inc.*, 403 F.2d 159, 161 (2d Cir. 1968), *cert. denied*, 393 U.S. 1026 (1969).

been questioned by any court since the enactment of the Williams Act in 1968.⁸ In contrast, Section 13(d)'s standing requirements and the context in which such a private right exists have created conflict between courts. In the Seventh Circuit, in particular, there exist two viable, yet divergent holdings relating to the scope of Section 13(d)'s implied cause of action. Accordingly, the issues addressed in this note include: (1) the scope of Section 13(d)'s implied cause of action; (2) whether the Seventh Circuit unnecessarily narrowed Section 13(d)'s implied cause of action through its holding in *Edelson v. Ch'ien*, 405 F.3d 620 (7th Cir. 2005) thereby creating a potential split between circuits; and, (3) the *Edelson* holding's implications with respect to corporate governance and, in particular, its possible chilling affect on the heightened corporate governance requirements set forth in the Sarbanes-Oxley Act, 15 U.S.C. § 7201 et seq..

Section I of this Note provides background regarding the Williams Act. Section II analyzes and explains *Indiana National Corp. v. Rich*, the Seventh Circuit case decided in 1983 adopting Section 13(d)'s implied cause of action. Section III discusses the recent Seventh Circuit decision, *Edelson v. Ch'ien*, which presented the first time the Seventh Circuit addressed the scope of Section 13(d)'s implied cause of action in more than 20 years.⁹ Section IV explains why the *Edelson* Court incorrectly held that the plaintiff did not have standing to assert a private right of action under section 13(d). Section V of this Note explains why the disclosure requirements set forth in Section 13(d) apply beyond the context of a tender offer. Finally, this article cautions that *Edelson* may have the adverse affect of discouraging corporate directors from questioning the propriety and legality of board decisions in conflict with the very purpose of the Sarbanes-Oxley Act, 15 U.S.C. § 7201 et seq. Furthermore, *Edelson* creates a conflict between circuits.

⁸ See *Ind. Nat'l Corp.*, 712 F.2d at 1183 (From its inception, Section 13(d) has impliedly had a private cause of action similar to that of Section 14(a), as that Section provided the model upon which Section 13(d) was created).

⁹ The *Edelson* holding directly contradicts that of the *Indiana National*.

I. BACKGROUND ON THE WILLIAMS ACT AND SECTION 13(D)'S PRIVATE RIGHT OF ACTION

Reacting to the increased use of cash tender offers to achieve corporate takeovers, Congress passed the Williams Act in 1968.¹⁰ The impetus behind the Act, as stated by its sponsor Senator Williams,¹¹ was to “close a significant gap in investor protection under the Federal securities laws by requiring the disclosure of pertinent information to stockholders when persons seek to obtain control of a corporation by a cash tender offer *or through open market or privately negotiated purchases of securities.*”¹² Prior to the adoption of the Williams Act, tender offers and third-party acquisitions of substantial amounts of stock, such that a potential for control was created, were not subject to substantive registration and disclosure requirements.¹³

In particular, Section 13(d) required any person who acquired more than 5% of a class of securities of a corporation to send to the issuer and file with the SEC a statement (Schedule 13D or 13G) disclosing, among other things, the identities of all persons on whose behalf the purchases had been made, the number of shares acquired, the source and amount of funds used in making the purchase, and the purpose of the purchases in relation to the acquisition of control.¹⁴ Disclosure is of paramount importance, as it enables investors to assess the potential for changes in corporate control and adequately evaluate a company's worth.¹⁵ Further, disclosure provides for added investor protection by minimizing the asymmetrical access to

¹⁰ Piper v. Chris-Craft Ind. Inc., 430 U.S. 1, 22 (1977).

¹¹ Harrison A. Williams Jr. was a Democrat who represented New Jersey in the United States Senate from 1959-1982. *See* http://en.wikipedia.org/wiki/Harrison_A._Williams.

¹² 113 Cong. Rec. 854 (1967); *See also* H.R. Rep. No. 1711, 90th Cong., 2d Sess. 4, *reprinted in* 1968 U.S. Code Cong. & Ad. News 2811, 2814.

¹³ Ind. Nat'l Corp. v. Rich, 712 F.2d 1180, 1183 (7th Cir. 1983).

¹⁴ *Id.* (citing 15 U.S.C. § 78m(d)(1)).

¹⁵ GAF Corp. v. Milstein, 453 F.2d 709, 719-720 (2d Cir. 1971), *cert. denied*, 406 U.S. 910 (1972).

information between normal investors and corporate insiders, which goes to the essence of the federal securities laws.

From the time of its enactment in 1968, Section 13(d) was understood by courts and legislators to impliedly contain a private right of action.¹⁶ Indeed, the Williams Act was patterned upon the protections already available in the proxy rules, Sections 14(a) of the Exchange Act, 15 U.S.C. § 78n, which courts had previously found to contain such an implied right.¹⁷ Then, in 1971, the Court of Appeals for the Second Circuit explicitly held that a private right of action for issuer corporations must be implied under Section 13(d).¹⁸ Shortly thereafter, the Supreme Court gave its imprimatur to the Second Circuit's ruling.¹⁹ Despite several amendments to the Williams Act, Congress left the remedy intact.²⁰

II. INDIANA NATIONAL CORP. V. RICH: AND THE COURT SAID, LET THERE BE SECTION 13(D)

In 1983, the Seventh Circuit addressed, for the first time, the scope of the implied private remedy under Section 13(d).²¹ Specifically, the issue addressed in *Indiana National Corp. v. Rich* was whether an implied private right of action existed for an issuer corporation to seek injunctive relief under Section 13(d) of the

¹⁶ *Ind. Nat'l Corp.* 712 F.2d at 1183; *see also* Statement by former SEC Chairman Manual F. Cohen during Hearing on S. 510 Before the Subcomm. On Securities of the Senate Comm. On Banking and Currency, 90th Cong., 1st Sess. 16 (1967) ("The procedures provided by the bill in the case of contested tender offers are analogous to those now followed when contending factions solicit proxies under the Commission's proxy rules").

¹⁷ *Ind. Nat'l Corp.* 712 F.2d at 1183.

¹⁸ *See GAF Corp.*, 453 F.2d at 719-720 (2d Cir. 1971).

¹⁹ *Ind. Nat'l Corp.* 712 F.2d at 1184; *see Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 59 n.9 (1975) (The Supreme Court assumed, without directly confronting the issue, that 13(d) provided for a private right of action to issuer corporations with respect to injunctive relief).

²⁰ *Ind. Nat'l Corp.* 712 F.2d at 1184; *see Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Curran*, 456 U.S. 353, 381-82 (1982).

²¹ *Ind. Nat'l Corp.* 712 F.2d at 1181.

Securities Exchange Act (“Exchange Act”) against a group of investors who had aggregated more than 5% of Indiana National Corporation’s stock.²²

In that case, the plaintiff, Indiana National Corporation (“Indiana National”), was a bank holding company engaged principally in the banking business through its wholly owned subsidiary, Indiana National Bank.²³ Indiana National’s stock was traded in the over-the-counter market, and was registered pursuant to Section 12 of the Exchange Act.²⁴ The defendants were a group of investors who, during 1981 and 1982, acquired more than 5% of Indiana National’s stock.²⁵ In accordance with Section 13(d), they filed a Schedule 13D in September of 1981, and subsequently amended it six times between then and August, 1982.²⁶

In July, 1982, Indiana National filed a complaint alleging that the defendants’ Schedule 13D contained materially false and misleading information, in that it failed to disclose, among other things, the defendants’ intention to acquire control of Indiana National.²⁷ The plaintiff sought a court order compelling defendants to file an amended Schedule 13D stating their intention to acquire control of Indiana National, as well as enjoining defendants from acquiring more shares of Indiana National and compelling them to divest themselves of a portion of the shares already held.²⁸ In response, the defendants filed a motion to dismiss arguing that Indiana National, as the issuer, had no standing to assert a claim under Section 13(d); the district court granted its motions on this ground.²⁹ On appeal, the Seventh Circuit reversed the district court’s holding, stating

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.* at 1182.

²⁸ *Id.*

²⁹ *Id.*

unequivocally that “an implied right of action exists in favor of an issuer under Section 13(d).”³⁰

In so holding, the court provided an extensive analysis of Section 13(d) standing as it pertains to issuer corporations via incumbent management. While conceding that Section 13(d)’s purpose was the protection of shareholders and not the protection of incumbent management or deterrence of takeover bids, the *Indiana National Corp.* Court found that it is through incumbent management that shareholders are protected, rendering the distinction between incumbent management and shareholders nominal.³¹ “In this sense,” stated the court, “the corporation’s standing to sue is representational.”³² It continued, the manner in which shareholder protection is provided by Section 13(d) “is by generating a ‘fair fight’ between incumbent management and the persons believed to be seeking to acquire control in order that the shareholders may make an intelligent decision between them when called upon to do so.”³³

Thus, incumbent management plays a vitally important role in protecting shareholder interests and monitoring the observance of Federal securities laws. Shareholders, by themselves, generally lack the capacity and knowledge to ensure that Section 13(d) is enforced and that a “fair fight” is provided.³⁴ In this respect, the issuer corporation via incumbent management, acts on the shareholders’ behalf in bringing a suit for injunctive relief until an accurate Schedule 13D is filed.³⁵ That is not to say that incumbent management represents the interests of the shareholders “in relation to who ultimately *wins* any potential struggle for control, but only insofar as corporate management acts to ensure the dissemination of accurate information about the identity, background and purpose of the persons

³⁰ *Id.*

³¹ *Id.* at 1185.

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

possibly seeking control of the corporation.”³⁶ As such, a corporation’s standing to sue under Section 13(d) is representational and should be afforded to (incumbent) management in those instances where both the management and shareholders are interested, “realistically” or “theoretically,” in preventing injury to any corporate interest resulting from a takeover by persons who are either incompetent or intent upon plundering the corporate assets.³⁷

III. EDELSON V. CH’IEN: WHAT THE SEVENTH CIRCUIT GIVETH, THE SEVENTH CIRCUIT TAKETH AWAY

More than twenty years after *Indiana National*, the Seventh Circuit once again addressed the scope of the implied private right of action under Section 13(d).³⁸ Specifically, the court in *Edelson v. Ch’ien* addressed whether the failure to disclose an intent to affect change in corporate control in a Schedule 13G disclosure provided a sufficient basis for the plaintiff to state a cause of action under Section 13(d).³⁹

In this case, the plaintiff, Harry Edelson (“Mr. Edelson”), was a director and shareholder of defendant Chinadotcom, the issuer, from 1999 until 2003.⁴⁰ Individually, the defendants included Peter Yip Hak Yung (“Mr. Yip”), CEO of Chinadotcom and shareholder, Raymond K.F. Ch’ien (“Mr. Ch’ien”), Executive Chairman of Chinadotcom’s board and shareholder, and Chinadotcom.⁴¹

In early January of 2003, both Mr. Edelson and another outside director openly disagreed with Mr. Yip and Mr. Ch’ien

³⁶ *Id.* (emphasis in the original).

³⁷ *Id.*

³⁸ *Edelson v. Ch’ien*, 405 F.3d 620, 626 (7th Cir. 2005).

³⁹ *Id.*

⁴⁰ *Id.* at 622. (Chinadotcom was a Cayman Island company, headquartered in Hong Kong whose stock traded on the NASDAQ exchange during all relevant times leading to this dispute).

⁴¹ *Id.* (Through a family corporation Mr. Yip beneficially owned almost 16.5 million shares in Chinadotcom, approximately 19% of the outstanding shares of the company).

concerning various corporate governance issues.⁴² In particular, they took issue with the company-sponsored stock buy-back program, which they believed to be ethically improper and possibly illegal.⁴³ Mr. Edelson questioned both Mr. Yip's and Mr. Ch'ien's motives in backing the program, as they stood to reap huge gains from the buy-back.⁴⁴ By way of example, Mr. Yip had purchased 4.3 million shares of Chinadotcom stock in a private transaction on January 14, 2003, at a price of \$2.50 per share.⁴⁵ The stock buy-back program – that Mr. Yip and Mr. Ch'ien so rigorously backed – called for the re-purchase of that stock at \$3.75 per share.⁴⁶

Prior to Mr. Yip's January 14 purchase, he filed a disclosure pursuant to Section 13(d), as he was the beneficial owner of more than 5% of the issued and outstanding shares of Chinadotcom stock.⁴⁷ However, Mr. Yip did not file a Schedule 13D; instead, he filed a Schedule 13G.⁴⁸ By rule, a shareholder may file a Schedule 13G, a less-onerous disclosure form allowed when the individual submitting the filing "[h]as not acquired the securities with any purpose, or with the effect of changing or influencing the control of the issuer."⁴⁹ In Mr. Yip's 13G disclosure he certified that (1) the securities he purchased were neither acquired nor held "for the purpose of, or with the effect of changing or influencing control of the issuer of the securities," and (2) that the securities were neither acquired nor held "in connection with or as a participant in any transaction having that purpose or effect."⁵⁰

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *Id.*; Edelson Complaint, 2004 WL 2174010 at ¶¶ 17-23 (N.D. Ill., May 17, 2004); Edelson Amended Complaint, 2004 WL 2173998 at ¶¶ 18-25 (N.D. Ill. Feb. 5, 2005).

⁴⁶ *Edelson*, 405 F.3d at 622.

⁴⁷ *Id.* at 623.

⁴⁸ *Id.*

⁴⁹ *Id.*; 17 C.F.R. § 240.13d-1(c)(1).

⁵⁰ *Edelson*, 405 F.3d at 623.

Meanwhile, Mr. Edelson's dispute with Mr. Yip and Mr. Ch'ien continued to escalate through the March 18, 2003 Board meeting.⁵¹ On April 16, 2003, Mr. Edelson sent an e-mail correspondence to Mr. Ch'ien alleging that the independent directors on Chinadotcom's Board were being "bull-dozed" in violation of the Sarbanes-Oxley Act, with the result that good corporate governance was being disregarded.⁵² Also during this same time frame, the Board was in the process of nominating a new slate of directors.⁵³ All three directors who served on the audit committee – Mr. Edelson, Mr. Beese, the other dissenting director, and Thomas Britt – had terms set to expire after the annual shareholder meeting.⁵⁴ The annual meeting notice sent to all Chinadotcom stockholders recommended the re-election of all three members, whose nominations were subsequently unopposed and uncontested.⁵⁵ Neither Mr. Yip nor Mr. Ch'ien asserted any overt objection whatsoever to Mr. Edelson's re-elections, and both purported to concur in the Board's recommendation that Mr. Edelson and the other candidates be elected.⁵⁶

However, on June 17, 2003, at the Chinadotcom Annual Meeting, Mr. Edelson was defeated in an election in which only 48% of the shares were voted.⁵⁷ Of the votes cast, 18,766,947 shares were voted in favor of Mr. Edelson's re-election, 28,264,956 were voted against Mr. Edelson's re-election, and 800 abstained.⁵⁸ All 16,577,905 shares beneficially owned by Mr. Yip were voted against Mr. Edelson, constituting more than two-thirds of the votes cast against him.⁵⁹ Moreover, Mr. Yip did not amend his previously filed Schedule 13G

⁵¹ *Id.*

⁵² *Id.* at 623-24.

⁵³ *Id.* at 623.

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.* (Mr. Edelson's complaint alleged that Mr. Yip and Mr. Ch'ien concealed their opposition to his re-election as part of a scheme to vote him off of the Board).

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.*

prior to voting all of his shares against Mr. Edelson,⁶⁰ leading the Chinadotcom shareholders to believe that the election at the 2003 Annual Meeting would be evenhanded.

In October of 2003, Mr. Edelson filed suit against Chinadotcom, alleging, among other things, violations of Section 13(d), and sought an order declaring the June 2003 election null and void, and ordering a new election.⁶¹ The gravamen of Mr. Edelson's complaint was that Mr. Yip violated Section 13(d) by not disclosing his plan to influence the control of Chinadotcom's existing board.⁶² Specifically, Mr. Edelson contended that Mr. Yip's Schedule 13G, filed after his January purchase of 4.3 million shares, certified that the shares would not be held for the purpose of or with the effect of changing or influencing control of the issuer.⁶³ Mr. Edelson argued further that once Mr. Yip decided to vote against him, as well as the other dissenting outside director, Mr. Yip could no longer make such a certification and was thereby required to file a Schedule 13D or amend his Schedule 13G, which he did not do.⁶⁴ Mr. Yip argued that the fact that a shareholder intends to vote shares in favor or against a director does not mean that the shareholder has "the purpose or effect of changing or influencing the control of the issuer of the securities."⁶⁵

The district court denied Mr. Edelson's request for injunctive relief and dismissed his claim finding that he lacked standing to bring a Section 13(d) action. The court reasoned that Congress did not intend Section 13(d) to serve as a mechanism for "ex-directors to settle old feuds."⁶⁶ In support of this argument, the district court acknowledged that *Indiana National* authorized a private right of action under Section 13(d), but relied on two district court decisions – one from Louisiana and the other from Maryland – holding that former

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 623.

⁶⁴ *Id.* at 624.

⁶⁵ *Id.*

⁶⁶ *Id.*

directors of a corporation could not bring suit under Section 13(d).⁶⁷ “If there is a spectrum of shareholder sophistication,” said the court, “with unsuspecting investors on one end, and well-informed members of management who can adequately protect their own interests on the other, then Edelson certainly lies closer to management than to the common shareholder.”⁶⁸ Thus, the court concluded that Mr. Edelson, as a director, was neither the appropriate representative of his interest as a shareholder nor those of other shareholders.⁶⁹

On appeal, the Seventh Circuit affirmed, but on grounds other than those relied upon by the district court.⁷⁰ Rather than focusing on Mr. Edelson’s status as an ex-director, the Seventh Circuit reasoned that he lacked any viable Section 13(d) claim *in his capacity as a Chinadotcom shareholder*.⁷¹ Specifically, the court held that Mr. Yip’s failure to disclose his intent under the circumstances of this case did not provide Mr. Edelson, as a shareholder, with a sufficient basis to state a cause of action.⁷² The court further concluded that Congress intended to recognize a private cause of action under Section 13(d) only in the context of a tender offer or other contest for control; therefore, Mr. Yip’s action in voting against Mr. Edelson fell outside of the scope of Section 13(d).⁷³ In support of its holding, the court proffered a characterization oft-repeated by courts that have addressed Section 13(d) claims:

Our review of the legislative history convinces us that the overriding purpose of Congress was to protect the individual investor when substantial shareholders or

⁶⁷ *Id.* at 624-25 (citing *Mates v. N. American Vaccine, Inc.*, 53 F.Supp.2d 814 (D. Md. 1999)); *Nowling v. Aero Serv. Int’l, Inc.*, 752 F.Supp. 1304 (E.D. La. 1990), notwithstanding plain language in *Ind. Nat’l* leading to the opposite conclusion.

⁶⁸ *Edelson*, 405 F.3d at 625.

⁶⁹ *Id.*

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*

management undertake to acquire shares in a corporation for the purpose of solidifying their own position in a contest over how or by whom the operation should be managed.⁷⁴

Section 13(d), in the court's own words, "was designed to provide information to the investor when faced with a tender offer or other accumulation or aggregation of stock that *could* affect corporate control."⁷⁵ In sum, despite Mr. Yip's accumulation of 19% of Chinadotcom's stock and questionable disclosure, Mr. Edelson's status as a shareholder and director charged with protecting common shareholders, Seventh Circuit case law favoring Mr. Edelson, and the complete absence of language in Section 13(d) limiting its scope to tender offers, the Seventh Circuit affirmed the district court's judgment against Mr. Edelson.

IV. THE DISTRICT COURT'S STANDING ANALYSIS

The Seventh Circuit should have reversed the district court's finding that Mr. Edelson did not have standing to assert a private right of action under Section 13(d) for three reasons. First, by focusing on Mr. Edelson's position as a former board member, as opposed to his status as owner of several hundred thousand Chinadotcom shares, the district court concluded that he was not within the class of people that Section 13(d) was enacted to protect.⁷⁶ Second, while claiming to embrace the *Indiana National* reasoning, the district court came to a conclusion directly contrary to its primary contention regarding Section 13(d) standing.⁷⁷ Finally, not only did the court of appeals

⁷⁴ *Id.* at 631; *see, e.g.,* Bath Indus., Inc. v. Blot, 427 F.2d 97 (7th Cir. 1970).

⁷⁵ *Edelson*, 405 F.3d at 631 (emphasis added).

⁷⁶ *See id.* at 625. ("If there is a spectrum of shareholder sophistication . . . Edelson certainly lies closer to management than to the common shareholder").

⁷⁷ *See* Ind. Nat'l Corp. v. Rich, 712 F.2d 1180, 1185 (7th Cir. 1983) (A corporation's standing to sue under Section 13(d) is representational and should be afforded to (incumbent) management in those instances where both the management and shareholders are interested, "realistically" or "theoretically," in preventing injury

uphold the district court's ruling for which extra-district (district court) case law was relied upon despite the existence of Seventh Circuit authority, the cases relied upon were inapposite. In doing so, the court created a potential conflict among the circuits as the Second Circuit reached an inapposite result in *GAF Corp. v. Milstein*.⁷⁸ Each of these points is further elucidated below.

A. *Mr. Edelson was a Shareholder*

Both Mr. Edelson and the Chinadotcom defendants agreed that the purpose of Section 13(d) was to protect shareholders, and further, that it provided a private right of action for injunctive relief in favor of shareholders.⁷⁹ Courts have uniformly found a private right of action on behalf of shareholders under Section 13(d) for claims involving injunctive relief.⁸⁰ Indeed, the Supreme Court has stated that the Williams Act's central thrust was to provide shareholders with more extensive protection under the Federal securities laws.⁸¹ The theme of investor protection was emphasized by Senator Williams on the day the Senate passed the Williams Act:

to any corporate interest resulting from a takeover by persons who are either incompetent or intent upon plundering the corporate assets).

⁷⁸ The district court modified the Seventh Circuit Court of Appeals holding in *Ind. Nat'l Corp.* by citing to *Mates v. N. American Vaccine, Inc.* and *Nowling v. Aero Serv. Int'l, Inc.*, both extra-district rulings. Further, both cases are inapposite. See Amicus Brief by the Securities and Exchange Commission in Support of Plaintiff (Mr. Edelson), 2004 WL 3760475, at *25-26 (7th Cir. Dec. 15, 2004).

⁷⁹ See *Edelson*, 405 F.3d at 631.

⁸⁰ See *Myers v. American Leisure Time Enters., Inc.*, 402 F.Supp. 213, 214 (D.C.N.Y. 1975); *Scott v. Multi-Amp Corp.*, 386 F.Supp. 44, 50 (D.N.J. 1974); *Jacobs v. Pabst Brewing Co.*, 549 F.Supp. 1050, 1059-63 (D. Del. 1982) (The Jacobs Court concluded that an implied private right of action for injunctive relief exists under Section 13(d) for shareholders of a target corporation); See also *Diceon Elecs., Inc. v. Calvary Partners, L.P.*, 772 F.Supp. 859, 863 (D. Del. 1991) (affirming the Jacobs Court finding).

⁸¹ See *Piper v. Chris-Craft Ind. Inc.*, 430 U.S. 1, 33-34 (1977); see also *Rondeau v. Mosinee Paper Corp.*, 422 U.S. 49, 58 (1975).

[The Federal securities laws] provide protections for millions of American investors by requiring full disclosure of information in connection with the public offering and trading of securities. These laws have worked well in providing the public with adequate information on which to base intelligent investment decisions. There are, however, some areas still remaining where the full disclosure is necessary for investor protection but not required by present law. One such area is the purchase by *direct acquisition or by tender offers* of substantial blocks of securities of publicly held companies. [The Williams Act] provides for investor protection in these areas.⁸²

Mr. Edelson was the investor in, and shareholder of, several hundred thousand Chinadotcom shares.⁸³ Despite his status as a shareholder, the district court found that Mr. Edelson was not entitled to seek injunctive relief under Section 13(d).⁸⁴ The court of appeals accepted, out of hand, the district court's reasoning that, because a majority of the injuries alleged by Mr. Edelson concerned his position as a member of the board as opposed to his position as a shareholder, he was not entitled to protection as a shareholder under Section 13(d).⁸⁵ This reasoning, however, is contradictory. By admitting that even one of Mr. Edelson's claims arose by virtue of his status as a shareholder, the court is then forced to acknowledge that he has those rights afforded all other shareholders, to wit, standing to sue under Section 13(d). Moreover, Mr. Edelson alleged that he, as a shareholder, was not informed by Mr. Yip and Mr. Ch'ien about their plans to change the composition of the Board.⁸⁶ If taken as true, there is no

⁸² Louis Loss & Joel Seligman, *Securities Regulation* 2165 (3d ed. 1990), quoting 113 Cong. Rec. 24664.

⁸³ See *Edelson*, 405 F.3d at 622.

⁸⁴ *Id.* at 625.

⁸⁵ *Id.* at 623, 625.

⁸⁶ *Id.* at 625.

question that Mr. Yip and Mr. Ch'ien would have been required to disclose their intent pursuant to Section 13(d). The extension of management's control over a company to the exclusion of dissenting parties is just the type of event that Section 13(d)'s disclosure requirement was intended to reveal to shareholders.⁸⁷ In addition, Schedule 13D itself includes the requirement that a filer must disclose any plan or intent to change the composition of corporate boards.⁸⁸ Yet, the court chose not to address any of these arguments.⁸⁹

Despite ultimately deciding against Mr. Edelson by reasoning that Section 13(d)'s implied cause of action applies only in the context of a tender offer or other contest for control,⁹⁰ the court's decision would presumably have been different if another shareholder brought the action. The *Edelson* Court approvingly cited to various language in the district court's holding admonishing Mr. Edelson for bringing suit. "Congress did not intend Section 13(d) to be a mechanism for ex-directors to settle old feuds."⁹¹ "This Court declines" to grant a "cause of action under Section 13(d) for former directors whom management has ousted Congress did not intend former directors to wield Section 13(d) on their own behalf."⁹² This argument is not without merit. However, the fact remains that Mr. Edelson was a shareholder despite his role as director. All shareholders are afforded rights under the federal securities laws, and justice is not served by vitiating those rights for shareholders who also happen to be corporate directors and officers of the company in which they own shares.

While the use of Section 13(d) as a mechanism for ex-directors to "settle old feuds" may be a nuisance to the court, it is

⁸⁷ See *Bath Indus., Inc. v. Blot*, 427 F.2d 97,109 (7th Cir. 1970); see also Amicus Brief by the Securities and Exchange Commission in Support of Plaintiff (Mr. Edelson), 2004 WL 3760475, at *22 (7th Cir. Dec.15, 2004).

⁸⁸ See Schedule 13D, Item 4.

⁸⁹ See *Edelson*, 405 F.3d at 625. (The court refused to address the issue of whether Mr. Edelson should be afforded those rights guaranteed general shareholders by Section 13(d)).

⁹⁰ *Id.* at 634.

⁹¹ *Id.* at 624.

⁹² *Id.* at 625.

worth the cost. Corporate insiders are the gate-keepers for common shareholders and are in the best position to identify and bring to light corporate foul play. Common shareholders are often too far removed from the inner workings of the company they own to effectively prevent potential violations of federal securities laws.⁹³ As such, ex-director-shareholders may actually be the best plaintiffs in a Section 13(d) suit. They are privy to the inner workings of the company yet still share the concerns of all other common shareholders – such as, the prudent and impartial management of the company for the benefit of all shareholders, not just the few in control. To preclude corporate insiders, and specifically ex-directors, from bringing suit under Section 13(d) because of their dual status as management and shareholder would constitute a setback in our federal securities law jurisprudence. Indeed, as stated by Justice Learned Hand, “it is one of the surest indexes of mature and developed jurisprudence . . . to remember that statutes always have some purpose or object to accomplish, whose sympathetic and imaginative discovery is the surest guide to their meaning.”⁹⁴ To read director-shareholders out of Section 13(d)’s implied private right of action would run directly contrary to this notion.

The court further accepted the Chinadotcom defendants’ argument that if Mr. Edelson was correct, Rule 13d-1(e)(1),⁹⁵ “taken to

⁹³ *GAF Corp. v. Milstein*, 453 F.2d 709, 721 (2d Cir. 1971).

⁹⁴ *Id.* at 716 (citing *Cabell v. Markham*, 148 F.2d 737, 739 (2d Cir. 1945)).

⁹⁵ Rule 13d-1(e)(1):

Notwithstanding paragraphs (b) and (c) of this section and Rule 13d-2(b), a person that has reported that it is the beneficial owner of more than five percent of a class of equity securities in a statement on Schedule 13G pursuant to paragraph (b) or (c) of this section, or is required to report the acquisition but has not yet filed the schedule, shall immediately become subject to Rule 13d-1(a) and Rule 13d-2(a) and shall file a statement on Schedule 13D within 10 days if, and shall remain subject to those requirements for so long as, the person:

(1) Has acquired or holds the securities with a purpose or effect of changing or influencing control of the issuer, or in connection with

its logical conclusion, would mean that no Schedule 13G filer would ever be able to vote its securities in a board election . . . without first filing a Schedule 13D because the mere voting of its securities is . . . equivalent to changing or influencing control of the issuer.”⁹⁶ This argument is misplaced. Section 13(d), as stated above, was intended to protect shareholders by requiring honest disclosure of one’s intent in accumulating large amounts of stock in a publicly held corporations. The argument was not that Mr. Yip would have been precluded from voting his shares without filing a Schedule 13D regardless of the manner in which he chose to vote.⁹⁷ Instead, Mr. Edelson argued that once Mr. Yip, as the beneficial owner of a significant block of Chinadotcom shares, decided to use the voting power associated with that block in an effort to *change* the composition of Chinadotcom’s Board, and thereby *alter* control over Chinadotcom, it was incumbent on him to disclose his intentions to do so.⁹⁸ In the absence of such a disclosure, the 2003 Chinadotcom annual meeting seemed, to all outward appearances, to be a mere corporate formality, at which the composition of the company’s Board would remain unchanged and the stewardship of the company would be in the hands of the same people who had been guiding its affairs.

Thus, if Mr. Yip had disclosed his opposition to Mr. Edelson, presumably more than 48% of the voting shares would have been voted at the meeting, and likely would have been in favor of Mr. Edelson’s re-instatement, as his election was uncontested.⁹⁹ In short, had Mr. Yip filed an honest disclosure, more shareholders would have voted, and Mr. Yip would have needed more than his 19% ownership in Chinadotcom to hand Mr. Edelson his defeat. In the court’s own words, Section 13(d) “was designed to provide information to the

or as a participant in any transaction having that purpose or effect, including any transaction subject to Rule 13d-3(b); and
(2) Is at that time the beneficial owner of more than five percent of a class of equity securities described in Rule 13d-1(i).

⁹⁶ See *Edelson*, 405 F.3d at 624.

⁹⁷ *Id.* at 623.

⁹⁸ *Id.*

⁹⁹ *Id.*

investor when faced with a tender offer or other accumulation or aggregation of stock that could affect corporate control.”¹⁰⁰ Ironically, the approach actually taken by the court led to the opposite conclusion.

Moreover, neither *Indiana National Corp.* nor any of the other circuit decisions recognizing a private right of action under Section 13(d) had ever before imposed a requirement that private actions under Section 13(d) were limited to situations involving tender offers or other accumulations of stock for the purpose of affecting corporate control. Instead, prior to the *Edelson* decision, the Seventh Circuit and other federal appellate courts had uniformly held that an issuer itself may sue on behalf of its shareholders when attempting to obtain injunctive relief compelling the disclosures that are required under Section 13(d).¹⁰¹

B. Indiana National Provided a Basis for Standing

Had the court followed its own precedent set in *Indiana National Corp.*, Mr. Edelson would have easily met the standing requirement, as his standing would have been akin to that of an issuer bringing suit on behalf of all shareholders.¹⁰² While the *Indiana National* Court makes clear that Section 13(d) was enacted solely for the protection of shareholders and was not intended to protect incumbent management or discourage takeover bids, it goes on to explain that incumbent management is often the vehicle by which shareholders' rights are protected.¹⁰³

The manner in which [Section 13(d)] protection is to be provided . . . is by generating a “fair fight” between the incumbent management and the persons believed to be

¹⁰⁰ *Id.* at 632.

¹⁰¹ See *Ind. Nat'l Corp. v. Rich*, 712 F.2d 1180, 1185-86 (7th Cir. 1983); accord *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1158 (9th Cir. 1992); *Gearhart Ind. Inc. v. Smith Int'l, Inc.*, 741 F.2d 707, 714-15 (5th Cir. 1984); *Dan River, Inc. v. Unitex Ltd.*, 624 F.2d 1216, 1224 (4th Cir. 1980).

¹⁰² See *Ind. Nat'l Corp.*, 712 F.2d at 1185.

¹⁰³ *Id.* at 1185-86.

seeking control in order that the shareholders may make an intelligent decision between them when called upon to do so. Yet the shareholders have neither the knowledge nor the capacity to ensure that Section 13(d) is enforced and a “fair fight” thus provided. In this respect, and for this limited purpose . . . *the issuer corporation acts on the shareholders’ behalf in bringing a suit for injunctive relief until an accurate Schedule 13D is filed. Without question, the incumbent management does not represent the shareholders with respect to who ultimately wins any potential struggle for control but only insofar as corporate management acts to ensure the dissemination of accurate information about the identity, background and purpose of the persons possibly seeking control of the corporation.* In this sense, the corporation’s standing to sue under Section 13(d) is representational. Of course, presumably there are many circumstances where both the management and the shareholders are interested sometimes quite realistically and sometimes only theoretically, in preventing the injury to the corporate interest which would result from a takeover by persons who are either incompetent or intent upon plundering the corporate assets.¹⁰⁴

The analysis, based on the *Indiana National* Court’s reasoning is straightforward. The Chinadotcom shareholders had neither the knowledge nor the capacity to ensure Mr. Yip’s and Mr. Ch’ien’s compliance with Section 13(d), as they were not privy to the conflict between the Mr. Edelson and the Chinadotcom defendants. Nor were the shareholders privy to the possible corporate governance issues arising from Mr. Yip’s and Mr. Ch’ien’s behavior – that is, the aggregation of power between two board members giving them the ability to plunder corporate assets and to make decisions for their sole

¹⁰⁴ *Id.* at 1185.

benefit. Mr. Edelson, therefore, in attempting to invalidate the election and require Mr. Yip to file an accurate Schedule 13D was functioning as the issuer bringing suit on behalf of the shareholders. In short, it was through Mr. Edelson that a “fair fight” was to ensue.¹⁰⁵ Representative standing is appropriate where management and shareholders’ interests are either theoretically or realistically aligned.¹⁰⁶ Accordingly, Mr. Edelson should have been granted standing.

C. Second Circuit Authority Supported Standing

Finally, the conclusion that Mr. Edelson should have had standing in this case is further supported by the Second Circuit’s decision in *GAF Corp. v. Milstein*.¹⁰⁷ The court stated:

The history and language of Section 13(d) make it clear that the statute was primarily concerned with disclosure of potential changes in control resulting from new aggregations of stockholdings and was not intended to be restricted to only individual stockholders who made

¹⁰⁵ The fact that Mr. Edelson was a director as opposed to a manager is also insignificant, as the *Edelson* Court itself characterizes his position as akin to a “well-informed member[] of management.” See *Edelson*, 405 F.3d at 625.

¹⁰⁶ *Ind. Nat’l Corp.*, 712 F.2d at 1186.

¹⁰⁷ Notably, at least four other circuits have explicitly followed the holding in *GAF Corp.* recognizing that issuers have a cause of action for injunctive relief. See *Chevron Corp. v. Pennzoil Co.*, 974 F.2d 1156, 1158 (9th Cir. 1992); *Gearhart Ind., Inc. v. Smith Int’l, Inc.*, 741 F.2d 707, 714 (5th Cir. 1984); *Ind. Nat’l Corp.*, 712 F.2d at 1184; *Dan River, Inc. v. Unitex Ltd.*, 624 F.2d 1216, 1224 (4th Cir. 1980); see also *CNW Corp. v. Japonica Partners*, 874 F.2d 193 (3d Cir. 1989)(implicitly assuming the existence of a cause of action for injunctive relief without discussion); *Chromalloy Am. Corp. v. Sun Chem. Corp.*, 611 F.2d 240 (8th Cir. 1979)(same); *Gen. Aircraft Corp. v. Lampert*, 556 F.2d 90, 94 n. 5 (1st Cir. 1977)(explicitly assuming the existence of such a cause of action without deciding); but see *Liberty Nat’l Ins. Holding Co. v. Charter Co.*, 734 F.2d 545, 555-59 (11th Cir. 1984) (holding that issuers have no cause of action for injunctive relief under Section 13(d)).

future purchases and whose actions were, therefore, more apparent. . . . It hardly can be questioned that a group holding sufficient shares can effect a takeover without purchasing a single additional share of stock.¹⁰⁸

Specifically, the court in *GAF Corp. v. Milstein* addressed whether the plaintiff-corporation had standing under Section 13(d) to seek an injunction against allegedly false and misleading filings by a group of shareholders.¹⁰⁹ The court also addressed the meaning of the term “acquire” as used in Section 13(d) and whether the change in beneficial interest of a number of shares constituted an “acquisition” despite the fact that the defendants did not actually acquire additional shares.¹¹⁰

The defendants were shareholders who collectively owned more than 10% of the shares in plaintiff GAF Corporation, and who allegedly conspired to affect change in the company’s management without disclosing their intent pursuant to Section 13(d).¹¹¹ The court held that, for purposes of Section 13(d), the conspiracy equated to an “acquisition” of shares by those individuals involved in the conspiracy, despite the fact that no additional shares were purchased.¹¹² A shareholder’s intent to shift the “*loci* of corporate power and influence” is an acquisition for purposes of Section 13(d).¹¹³ Such acquisitions are “hardly dependent on an actual transfer of legal title to shares.”¹¹⁴ Section 13(d) is “primarily concerned with disclosure of *potential changes* in control” and was not meant to be restricted to

¹⁰⁸ *GAF Corp. v. Milstein*, 453 F.2d 709, 718 (2d Cir. 1971).

¹⁰⁹ *Id.* at 720.

¹¹⁰ *Id.* at 715.

¹¹¹ *Id.* at 713.

¹¹² *Id.* at 717-18.

¹¹³ *Id.* at 718.

¹¹⁴ *Id.* (“The alleged conspiracy on the part of the [plaintiffs] is one clearly intended to be encompassed within the reach of Section 13(d)”).

transparent attempts by shareholders to assert control over a company.¹¹⁵

In the event that a shareholder files a false and misleading Section 13(d) filing, the *GAF* Court was equally clear on who has standing to sue. Whether it be the SEC¹¹⁶ issuer, management, or shareholder, the person in the “best position to enforce Section 13(d)” should have standing to sue under the statute.¹¹⁷ Indeed the issuer, or a representative of the issuer such as Mr. Edelson, “in the course of constantly monitoring transactions in its stock” will regularly be in the best position to know when there has been a failure to file or if a filing is false and misleading.¹¹⁸ “Moreover, the issuer [via management] has not only resources, but the self-interest so vital to maintaining an injunctive action.”¹¹⁹ While this approach may play upon management’s self interest, this danger can be adequately counteracted by the court’s careful scrutiny of claims so as to ensure that investors’ interests are being protected.¹²⁰

According to *GAF Corp.*, Mr. Edelson’s claim against Chinadotcom should have fit squarely within the realm of Section 13(d) protection. Mr. Yip, as owner of 19% of Chinadotcom’s shares, had a duty to disclose that he sought to use those shares to effect change in Chinadotcom’s governing body. Had he properly disclosed his intent, all of Chinadotcom’s shareholders would have been put on notice that a potential change in control would result from the 2003 election and more shareholders probably would have voted.

In response to the query whether Mr. Edelson should have had standing to seek injunctive relief it is inadequate to argue simply

¹¹⁵ *Id.*

¹¹⁶ The SEC has brought suit against shareholders for violating Section 13(d). See *SEC v. Amster & Co.*, 762 F.Supp. 604 (S.D.N.Y. 1991); *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149 (D.C. Cir. 1978); *SEC v. First City Financial Corp., Ltd.*, 890 F.2d 1215 (D.C. Cir. 1989).

¹¹⁷ *GAF Corp.*, 453 F.2d at 719.

¹¹⁸ *Id.* at 719-21.

¹¹⁹ *Id.* at 719.

¹²⁰ *Id.* at 719-20.

that the SEC can proceed under penal provisions.¹²¹ The issuer, through its officers and directors, are the only parties which can “promptly and effectively police Schedule 13D filings, for it is fair to assume that it carefully scrutinizes changes in its stock-ownership – particularly of the sort which can initiate control.”¹²² Even if the SEC had the requisite manpower to delve into the details of each filing pursuant to Section 13(d), it does not have the issuer’s day-to-day familiarity with the facts which would enable it to accurately appraise the statements in such disclosures.¹²³ Certainly, “[a]n already overburdened Commission staff, taxed with reviewing increased filings under the securities acts, [will] welcome a ‘necessary supplement’ to its action.”¹²⁴

Nor is it realistic to expect shareholders to deter persons from filing inaccurate statements by resort to the antifraud provisions.¹²⁵ “Stockholders are generally unaware of the necessary background information to judge the truth or falsity of the statements.”¹²⁶ Moreover, since federal securities laws do not require the filings pursuant to Section 13(d) to be disseminated to the shareholders, they are not immediately put on notice that new company filings have occurred.¹²⁷ In contrast, officers and directors are given immediate notice as filings are required to be disseminated to them under the federal securities laws.¹²⁸ Additionally, “there may be instances where no shareholder has purchased or sold shares in reliance on the statements. In that event, even if the shareholders had standing there would be little incentive to maintain an action” because the recoverable damages would amount to a fraction of the cost incurred

¹²¹ *Id.* at 721.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.*

¹²⁸ *Id.*

to bring suit.¹²⁹ The onus then falls completely on the shoulders of officers and directors to ensure compliance with federal securities laws and to adequately protect the collective interests of passive shareholders.

While the advent of EDGAR provides for increased shareholder access to filings, it would be unreasonable to require passive shareholders to police all executive decisions by themselves without the assistance of insiders who have an affirmative duty to such shareholders and are privy to information providing context to questionable executive decisions. In sum, corporate directors should be encouraged to monitor the legality of executive decisions and should further be encouraged to bring suit when false and deceptive filings are made by executive officers. Doing so provides for the complete and adequate protection of shareholders as contemplated by the federal securities laws.

V. CONTEXT IS EVERYTHING: SECTION 13(D)'S PRIVATE RIGHT OF ACTION WAS MEANT TO APPLY BROADLY

Ultimately, the death knell in Mr. Edelson's case was the court's unprecedented holding that section 13(d) applies only in the context of a tender offer or other contest for control.¹³⁰ The plain language and legislative history of Section 13(d) provide for a much broader range of cases. Further, the rules adopted by the SEC pursuant to Section 13(d) extend well beyond the tender offer context.¹³¹

To determine the scope of Section 13(d), we must first look to the statute's plain language.¹³² Section 13(d) broadly states that "[a]ny person [who, after acquiring a class of securities registered under Section 12 is] directly or indirectly the beneficial owner of more than 5 per centum of such a class" is required to make certain

¹²⁹ *Id.*

¹³⁰ *Edelson v. Ch'ien*, 405 F.3d 620, 634 (7th Cir. 2005).

¹³¹ *SEC Amicus Brief*, 2004 WL 3760475, at *30.

¹³² *Edelson*, 405 F.2d at 632.

disclosures.¹³³ In fact, as the *Edelson* Court concedes, Congress did not use the term “tender offer” anywhere in Section 13(d).¹³⁴ Therefore, by simply looking at the plain language of the statute, there is no sound basis for concluding that it applies only to a situation which it does not even mention.¹³⁵ The court goes on, however, to look at Section 13(d)’s triggering requirements and interprets Congress’ intent to restrict it to tender offer’s by focusing on the word “acquiring” as used in 15 U.S.C. § 78m(d)(1), which states that disclosure is required where an individual “acquir[es] directly or indirectly the beneficial ownership” of five percent of any class of security.¹³⁶

There are several problems with Seventh Circuit’s approach. First, this argument does not address the obvious lack of the term “tender offer” in the statute. Second, as discussed above, the *GAF* Court already determined that “aggregation” and “acquisition” are synonymous for purposes of Section 13(d).¹³⁷ In view of the finding in *GAF*, the *Edelson* Court’s emphasis on the term “acquiring” was unsubstantiated. Mr. Yip accumulated (or aggregated) a 19% ownership interest in Chinadotcom, which is well beyond the 5% threshold set forth in Section 13(d)’s triggering requirements.¹³⁸ As beneficial owner of more than 5% of the stock, Mr. Yip was required

¹³³ See Securities Exchange Act § 13(d); see also *SEC Amicus Brief*, 2004 WL 376075, at *27. (“While the increase in cash tender offers was the genesis of the Williams Act, [the] assertion that Section 13(d) only applies to tender offers or contests for control of the issuer is nonsense. The Williams Act’s coverage is very broad”).

¹³⁴ *Edelson*, 405 F.2d at 632; See also Section 13(d).

¹³⁵ See *SEC Amicus Brief*, 2004 WL 376075, at *29 (“The statute . . . expressly requires disclosure even where there is no control-purpose or contest for control. The statute requires ‘any person’ who accumulates 5 percent of a class of stock of an issuer to make the appropriate filings and include the disclosure required by the form”).

¹³⁶ *Edelson*, 405 F.2d at 632.

¹³⁷ See *GAF Corp. v. Milstein*, 453 F.2d 709, 718 (2d Cir. 1971) (It should also be noted that Congress has not taken any action to vitiate the *GAF* Court’s analysis, which has stood now for 35 years).

¹³⁸ See *Edelson*, 405 F.2d at 622-23.

to honestly disclose his intent with regards to the stock so as to inform the shareholders and the market of a potential change in control.¹³⁹

Finally, Section 14(d)(1) of the Exchange Act speaks directly, and exclusively, to tender offers.¹⁴⁰ Notably, that section sets forth the specific procedure to be used in the context of tender offers and it

¹³⁹ See *GAF Corp.*, 453 F.2d at 717 (The goal of section 13(d) “is to alert the market place to every large, rapid aggregation or accumulation of securities, regardless of the technique employed, which might represent a potential shift in corporate control.”); see also *Treadway Companies, Inc. v. Care Corp.*, 638 F.2d 357, 380 (2d Cir. 1980); *Gearhart Ind. Inc. v. Smith Int’l, Inc.*, 741 F.2d 707, 715 (5th Cir. 1984); *SEC Amicus Brief*, 2004 WL 376075, at *29.

¹⁴⁰ Securities Exchange Act § 14(d)(1):

It shall be unlawful for any person, directly or indirectly, by use of the mails or by any means or instrumentality of interstate commerce or of any facility of a national securities exchange or otherwise, to make a tender offer for, or a request or invitation for tenders of, any class of any equity security which is registered pursuant to Section 12 of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in Section 12(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940, if, after consummation thereof, such person would, directly or indirectly, be the beneficial owner of more than 5 per centum of such class, unless at the time copies of the offer or request or invitation are first published or sent or given to security holders such person has filed with the Commission a statement containing such of the information specified in Section 13(d) of this title, and such additional information as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors. All requests or invitations for tenders or advertisements making a tender offer or requesting or inviting tenders of such a security shall be filed as a part of such statement and shall contain such of the information contained in such statement as the Commission may by rules and regulations prescribe. Copies of any additional material soliciting or requesting such tender offers subsequent to the initial solicitation or request shall contain such information as the Commission may by rules and regulations prescribe as necessary or appropriate in the public interest or for the protection of investors .

makes reference to Section 13(d)'s disclosure requirements as the method by which disclosure should be made in the tender offer context.¹⁴¹ To read Section 13(d) so narrowly as to apply only in the context of a tender offer, or other similar contest for control, would be to render it a redundancy in the federal securities laws regime, as Section 14(d) already covers the field.¹⁴² Certainly, the drafters of the Williams Act and, specifically, Section 13(d) did not intend for it to be a redundancy as they were specifically filling the "gap" remaining in securities law regime in existence at the time.¹⁴³

Further evidence of Section 13(d)'s broad scope is found in the statute's legislative history. Manual Cohen, SEC Chairman in 1967, informed Congress that the Williams Act was to deal with stock acquisitions in three contexts: first, in the context of any acquisition of stock by means of a cash tender offer of more than 5% (10% at the time of enactment) of any class of stock of a publicly held company; second, in the context of other acquisitions, outside of cash tender offers, by any person or group of more than 5% of any class of stock of a publicly held company; and third, in the context of an issuer's repurchase of its own outstanding shares.¹⁴⁴ Congress enacted the Williams Act with the understanding that it would require disclosure of "the material facts concerning the identity, background, and plans of the person or group making a tender offer or acquiring a substantial amount of securities."¹⁴⁵

With respect to Section 13(d)'s plain language and legislative history, there is an absence of support for the contention that it applies only to the tender offer context (or in the context of other similar

¹⁴¹ *Id.*

¹⁴² *Id.*

¹⁴³ See *supra* note 11 and accompanying text.

¹⁴⁴ Full Disclosure of Corporate Equity Ownership and in Corporate Takeover Bids: Hearings Before the Subcommittee on Securities of the Committee on Banking and Currency, 90th Cong. 1st Sess. 16, 33 (1967); see also *SEC Amicus Brief*, 2004 WL 376075, at *27.

¹⁴⁵ S. Rep. No. 550, 90th Cong., 1st Sess. 4 (1967); see also *SEC Amicus Brief*, 2004 WL 376075, at *28.

contests for control). The SEC, in support of Mr. Edelson, put it most aptly:

[N]othing in Section 13(d) limits its coverage to rapid accumulations. While this may have been the typical scenario with which the section was concerned, it requires filing and disclosure, subject to certain exceptions not applicable [in *Edelson v. Ch'ien*], whenever and however the 5 percent threshold is crossed. Material changes in the facts set forth in the disclosure schedules, such as the acquisition or disposition of one percent or more of the subject security, must also be reported in the amended filing irrespective of whether such changes occur in the context of a tender offer or control contest.¹⁴⁶

In sum, “[t]he disclosures required of ‘any person’ by section 13(d) . . . apply regardless of whether a tender offer or *any* other effort to change or influence control is contemplated or pursued.”¹⁴⁷ The Williams Act, and specifically Section 13(d), was enacted to provide investors with broad protection.¹⁴⁸ “Any judicial impetus to cut back on the seeming thrust of the statute must be scrutinized in light of . . . the amendment which broadened the impact of Section 13(d) by reducing the threshold triggering of the statute from 10% holdings to 5%.”¹⁴⁹ Further, “the statute cannot be faulted” if, “as a by-product, management . . . becomes aware of those seeking to seize control of the corporation” and, consequently, files suit.¹⁵⁰

¹⁴⁶ *SEC Amicus Brief*, 2004 WL 376075, at *29 n.17.

¹⁴⁷ *V Loss & Seligman, Securities Regulation* 2176; *see Chromalloy Am. Corp. v. Sun Chem. Corp.*, 611 F.2d 240, 245 (8th Cir. 1979) (“[A] securities purchaser is required to disclose the purpose of the purchase . . . regardless of whether the underlying purpose is to acquire control of the issuer”); *see also SEC Amicus Brief*, 2004 WL 376075, at *28-29.

¹⁴⁸ *See Piper v. Chris-Craft Ind. Inc.*, 430 U.S. 1, 33-34 (1977).

¹⁴⁹ *GAF Corp. v. Milstein*, 453 F.2d 709, 719 n. 19 (2d Cir. 1971).

¹⁵⁰ *Id.*

The *Edelson* Court rejected Mr. Edelson's and the SEC's final argument that the implementing regulations further elucidate the broad scope of the statute.¹⁵¹ The court summarily rejected the argument without citing to any definitive language in Section 13(d) to support the court's contention that the statute applies only in the context of a tender offer.¹⁵² Nor did the court provide any substantive legislative history to support its contention.¹⁵³ There is no doubt that the language of the statute controls and the rules adopted pursuant thereto can provide only moderate interpretive authority.¹⁵⁴ However, as argued above, the statutory language is very broad and the legislative history further supports a broad reading of it. The implementing regulations simply provide a final means of interpreting the scope of the statute. According to the Rules adopted by the SEC pursuant to Section 13(d), any person unable to certify that an acquisition of stock was made without an underlying intent to affect control must file a Schedule 13D, even if a Schedule 13G had previously been filed.¹⁵⁵ Like the statute itself and its legislative history, the rules allow for the broad application of section 13(d)'s private cause of action and disclosure requirements, an application extending well beyond tender offers and other contests for control.

Finally, despite the court's unprecedented formulation of Section 13(d)'s implied private right of action, Mr. Edelson's claim still fit within the new parameters set by the court. The circumstances leading up to Mr. Edelson's claim included the accumulation of stock by Messrs. Yip and Ch'ien directly before the election of Chinadotcom's Board was to take place¹⁵⁶ and the use of those newly

¹⁵¹ *Edelson v. Ch'ien*, 405 F.3d 620, 633 (7th Cir. 2005) ("[W]e cannot look at the implementing regulations with the same authority as we do statutory language and legislative history in discerning whether Congress intended to recognize a private cause of action").

¹⁵² *Id.*

¹⁵³ *Id.*

¹⁵⁴ *Touche Ross & Co. v. Redington*, 442 U.S. 560, 577 n.18 (1979).

¹⁵⁵ See Rules 13d- (c); 13d-1(e)(1); See also *SEC Amicus Brief*, 2004 WL 376075, at *30-31.

¹⁵⁶ *Edelson*, 405 F.3d at 622.

acquired shares to oust Mr. Edelson from the Board¹⁵⁷ without disclosing such intent to the shareholders.¹⁵⁸ Obviously, the accumulation of stock by Messrs. Yip and Ch'ien was one that could affect corporate control. In fact, such accumulation did affect corporate control.

VI. THE BIG CHILL: THE EDELSON HOLDING AND THE SARBANES-OXLEY ACT'S HEIGHTENED CORPORATE GOVERNANCE REQUIREMENTS

Directors and officers of corporations are charged with a fiduciary duty of care,¹⁵⁹ "which often manifests itself in the form of a monitoring function."¹⁶⁰ As a director, this monitoring function stems from the principle that all corporate affairs must be managed under the direction of the board of directors.¹⁶¹ "Courts and commentators interpret this monitoring duty to mean that directors, individually and as a group, have an oversight function."¹⁶² Additionally, the Sarbanes-Oxley Act, 15 U.S.C. § 7201 et seq., has codified a number of requirements there. By way of example, under Sections 301 and 302 of that Act, corporate executives are required to implement and maintain internal controls, and provide an annual report speaking to

¹⁵⁷ *Id.* at 623.

¹⁵⁸ *Id.*

¹⁵⁹ See, e.g., *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (Del. 1985).

¹⁶⁰ Lisa M. Fairfax: *The Sarbanes-Oxley Act as Confirmation of Recent Trends in Director and Officer Fiduciary Obligations*, 76 ST. JOHN'S L. REV. 953, 955 (2002).

¹⁶¹ *Id.*; see Model Bus. Corp. Act § 8.01(b) ("All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors...."); see also §§ 8.30(a) and 8.42(a) (corporate directors must act in good faith and in a manner believed to be in the best interest of the corporation).

¹⁶² 76 ST. JOHN'S L. REV. at 955; see Model Bus. Corp. Act. § 8.30 (b) (directors must devote their attention to their oversight function); *Briggs v. Spaulding*, 141 U.S. 132, 147 (1891) (directors have a duty to supervise and manage corporate affairs); *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963) (directors have a duty to actively supervise and manage corporate affairs).

the viability and efficiency of that system.¹⁶³ Further, Section 403 amended the title of Section 16 of the Exchange Act to read “Disclosures of Transactions Involving Management and Principal Stockholders.”¹⁶⁴ Presumably, this was done to specify the broad scope of disclosures that should be monitored by corporate executives. The need for corporate directors to actively monitor and seek information pertaining to corporate conduct has not been lost on the SEC either. The SEC, after investigating several directors, concluded that their general lack of knowledge apropos important company events “demonstrate[d] the need for adequate regularized procedures under the overall supervision of the Board to ensure that proper disclosures are being made.”¹⁶⁵

Mr. Edelson was simply ensuring that proper disclosures were being made. He did so with an eye towards adequately performing his heightened monitoring duty as a corporate director. While *Edelson* did not directly address the Sarbanes-Oxley Act, its holding will likely have a negative impact on the heightened duty of Board members to oversee and monitor disclosures made by corporate executives and large shareholders. At the very least, it sends the message to Board members that monitoring disclosures and addressing probable inadequacies in certain disclosure may cost them their positions – a disincentive to scrutinize disclosures.

The *Edelson* holding has further negative implications with regard to the Sarbanes-Oxley Act, 15 U.S.C. §7201 et seq. Under Section 406(c)(1)-(3) of that Act, senior financial officers, i.e. Mr. Yip and Mr. Ch’ien, are required to ethically and honestly conduct their business affairs, “including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships”

¹⁶³ 76 ST. JOHN’S L. REV. at 969; See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 301, § 302, 116 Stat. 745, 776.

¹⁶⁴ See Sarbanes-Oxley § 403.

¹⁶⁵ 76 ST. JOHN’S L. REV. at 970; Report of Investigation in the Matter of National Telephone Co., Inc., Relating to Activities of Outside Directors of National Telephone Co., Inc., Exchange Act Release No. 34-14380, at *4 (Jan. 16, 1978), available at 1978 WL 171339 (noting that outside directors must maintain a familiarity with company documents and filings).

and full “compliance with applicable governmental rules and regulations.” A serious inconsistency arises then between the *Edelso* holding and Sarbanes-Oxley. By virtue of *Edelso*, senior financial officers of publicly held companies are encouraged to handle personal conflicts by accumulating large stakes in their company and ousting their foes, despite what may be in the best interest of the company and without the requirement that they disclose their plan to affect corporate control. This conduct can hardly be called ethical, but taken to its logical next step, the *Edelso* holding encourages such behavior.

There is yet another conflict between this holding and Sarbanes-Oxley, specifically, section 1514A. That section encourages employees of publicly held companies to question the propriety and legality of decisions made by corporate executives by offering protection against any retaliatory action taken against them as a result of their inquiring. Mr. Edelso was presumably ousted for questioning the propriety of Mr. Yip's buy-back plan, and the court took no steps to protect Mr. Edelso. The message this case sends to corporate directors is to stay quiet in the face of potential federal securities laws violations as corporate officers who bring up these issues will be ousted. The unfortunate result is that good corporate governance will be disregarded in favor of job security, and the heightened corporate governance requirements set forth in the Sarbanes-Oxley Act will be eroded by the cases that follow the precedent set by *Edelso*.

CONCLUSION

In deciding *Edelso v. Ch'ien*, the Seventh Circuit Court of Appeals should have reversed the district court's finding that Mr. Edelso did not have standing to assert a private right of action under Section 13(d). Mr. Edelso had standing to sue both in his capacity as a shareholder and director. Further, the court erred in limiting the scope of Section 13(d) to issues arising solely in the context of a tender offer or other contest for control. The statute itself, as well as its legislative history and the rules adopted pursuant to it, lead to the conclusion that the disclosure requirements of Section 13(d) extend beyond the tender offer context. By limiting Section 13(d)'s remedy to

those actions arising out of tender offers, the court in *Edelson v. Ch'ien* unnecessarily narrowed the statute's broad scope. Under the court's construction of section 13(d)'s private cause of action, executive-stockholders of publicly held companies are all but encouraged to conceal their intent to affect change in a company's management by filing a schedule 13G disclaiming an intent to affect control, vote their shares despite having concealed their actual intent, affect change in the company management, and walk away knowing that the manager or director that they effectively ousted has no standing to sue. Moreover, the holding in *Edelson* may have a chilling effect on the Board's heightened oversight and monitoring functions as set forth in the Sarbanes-Oxley Act and creates serious potential for conflict between circuits.